

IRS



Fact Sheet

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Highlights of 2006 Tax Law Changes

FS-2007-2, January 2007

New energy-saving tax credits, expanded retirement savings incentives and new rules for giving to charity are among the changes taxpayers will find when they start filling out their 2006 federal income tax returns.

More information about the changes, summarized below, can be found on IRS.gov and in various IRS documents, including the instructions for Form 1040.

In addition, some important changes, not covered here, are addressed in separate fact sheets. They include:

- FS 2007-1, One-Time Tax Refund Available to Long-Distance Telephone Customers
- FS-2007- 3, Recently Enacted Tax Law Extends State Sales Tax Deduction
- FS-2007-4, Special Steps Needed for Paper 1040 Filers to Claim Late Tax Changes
- FS-2007-5, Taxpayers Have More Direct Deposit Options for their 2006 Refunds
- FS-2007- 9, Credit Available for Taxpayers Who Purchase or Lease Hybrid Vehicles In 2006

New Energy-Saving Tax Credits

- A ten-percent credit can be claimed for various energy-saving improvements made to a taxpayer's main home. The credit is based on the cost of new energy-efficient improvements including insulation, exterior windows, exterior doors, water heaters, heat pumps, central air conditioners, furnaces and hot water boilers. The overall credit is limited to \$500 and further dollar limits apply to specific components (for example, 200 for windows).
- Separately, there is a thirty-percent credit for the cost of photovoltaic property, solar water heating property and fuel cell property.
- These credits are claimed on Form 5695. See the instructions for this form for more information.

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Contribution Limits Raised for IRAs and Other Retirement Plans: Special Rules for Military

- For 2006, the contribution limit for Roth and traditional IRAs rises to \$5,000, up from \$4,500 in 2005, for those age 50 or over. For those under 50, the limit remains unchanged at \$4,000.
- The \$10,000 phase-out range for IRA deductions for those covered by a retirement plan begins at income of \$75,000 if married filing jointly or a qualifying widow(er), up from \$70,000 in 2005. It still begins at \$50,000 for a single person or head of household and at \$0 for a married person filing a separate return. Use the worksheet in the instruction booklet for Line 32, Form 1040 or Line 17, Form 1040A to figure the IRA deduction.
- The elective deferral (contribution) limit for employees who participate in 401(k), 403(b) and most 457 plans rises to \$15,000. For SIMPLE plans, the limit remains at \$10,000. The catch-up contribution limit for persons age 50 or older rises to \$5,000 for 401(k), 403(b) and 457 plans and to \$2,500 for SIMPLE plans.
- Beginning in 2006, 401(k) and 403(b) plans can create a qualified Roth contribution program so that participants may choose to have part or all of their elective deferrals to the plan designated as after-tax contributions. Despite the name, a so-called "Roth 401(k)" is not the same as a Roth IRA.
- Military members serving in Iraq, Afghanistan and other combat zone localities can count tax-free combat pay when figuring how much to contribute to a Roth or traditional IRA. Because taxpayers usually must have taxable earned income, members of the military whose earnings came from tax-free combat pay were often barred from putting money into an IRA. This change is retroactive to 2004, and eligible taxpayers have until May 28, 2009 to make contributions for 2004 and 2005. Taxpayers who have already filed returns for 2004 and 2005 and choose to make these special back-year contributions to a traditional IRA must report them on an amended return (Form 1040X), along with, in some cases, Form 8606. See IRS News Release IR-2006-129 for more information.
- Military reservists, including members of the National Guard, called to active duty can receive payments from their individual retirement accounts, 401(k) plans and 403(b) tax-sheltered annuities, without being subject to the additional ten-percent early-distribution tax. The ten-percent tax that normally applies to most retirement distributions received before age 59 ½ is waived for reservist called to active duty for at least 180 days or for an indefinite period. Eligible reservists activated after Sept. 11, 2001 and before Dec. 31, 2007 qualify for this relief. Although the ten-percent early-distribution tax does not apply, regular income taxes continue to apply to these payments in most cases. For more information, see IRS News Release IR-2006-152.

New Rules for Giving to Charity

- To be deductible, clothing and household items donated to charity after Aug. 17,

2006, must be in good used condition or better. However, a taxpayer may claim a deduction of more than \$500 for any single item, regardless of its condition, if the taxpayer includes a qualified appraisal of the item with the return. Household items include furniture, furnishings, electronics, appliances, and linens.

- To deduct any charitable donation of money, taxpayers must have a bank record or a written communication from the recipient showing the name of the organization and the date and amount of the contribution. Though taxpayers are already required to keep records to support their contribution deductions, this new provision is designed to provide greater certainty, both to taxpayers and the government, in determining what may be deducted as a charitable contribution. This provision applies to contributions made in taxable years beginning after Aug. 17, 2006. For taxpayers that file returns on a calendar-year basis, including most individuals, the new provision applies to contributions made beginning in 2007.
- An IRA holder, age 70 ½ or over, can directly transfer tax-free, up to \$100,000 per year to an eligible charity. This option is available in tax years 2006 and 2007. Eligible IRA holders can take advantage of this provision, regardless of whether they itemize their deductions. Funds must be contributed directly by the IRA trustee to the eligible charity. Transferred amounts are counted in determining whether the holder has met the IRA's required minimum distribution rules. For more information on these changes and tips for donating to charity, see IRS News Release IR-2006-192 (<http://www.irs.gov/newsroom/article/0,,id=164997,00.html>).

Kiddie Tax — Age and Income Changes

- Children under 18 who receive taxable investment income may need to figure tax using their parents' higher marginal rates. The tax does not apply to a married child who files a joint return. In the past, the so-called "kiddie" tax only applied to children under the age of 14. Also, the amount of taxable investment income a child can have without being taxed at their parent's rate rises to \$1,700, up from \$1,600. The rest of the child's taxable income — earned income plus unearned income minus the standard deduction — is taxed at the child's regular rates.

AMT Exemption Increased for One Year

- For tax year 2006, the alternative minimum tax exemption rises to \$62,500 for a married couple filing a joint return, up from \$58,000 in 2005, and to \$42,500 for singles and heads of household, up from \$40,250. Under current law, these exemption amounts will drop to \$45,000 and \$33,750, respectively, in 2007.

Standard Mileage Rates Adjusted for 2006

- The standard mileage rate for business use of a car, van, pick-up or panel truck is 44.5 cents a mile.

- The standard mileage rate for the cost of operating a vehicle for medical reasons or as part of a deductible move is 18 cents a mile.
- The standard mileage rate for using a car to provide charitable services solely related to Hurricane Katrina is 32 cents per mile. Otherwise, the rate for providing services to charitable organizations is set by law and remains at 14 cents a mile.

Inflation Adjustments for 2006

Personal exemptions and standard deductions rise, tax brackets are widened and more than three dozen individual and business tax provisions are adjusted to keep pace with inflation. A complete rundown of these changes can be found at "[2006 Inflation Adjustments Widen Tax Brackets, Change Tax Benefits](#)."

Popular items adjusted include the following:

- The value of each personal and dependency exemption is \$3,300, up \$100 from 2005. Most taxpayers can take personal exemptions for themselves and an additional exemption for each eligible dependent. An individual who qualifies as someone else's dependent cannot claim a personal exemption, and personal and dependency exemptions are phased out for higher-income taxpayers.
- The standard deduction is \$10,300 for married couples filing a joint return and qualifying widow(er)s, a \$300 increase over 2005; \$5,150 for singles and married individuals filing separate returns, up \$150; and \$7,550 for heads of household, up \$250. Higher amounts apply to blind people and senior citizens. The standard deduction is often reduced for a taxpayer who qualifies as someone else's dependent. Nearly two out of three taxpayers take the standard deduction, rather than itemizing deductions, such as mortgage interest, charitable contributions, and state and local taxes.
- The maximum earned income tax credit is \$4,536 for taxpayers with two or more qualifying children, \$2,747 for those with one child and \$412 for people with no children. Available to low and moderate income workers and working families, the EITC helps taxpayers whose incomes are below certain income thresholds, which in 2006, rise to \$38,348 for those with two or more children, \$34,001 for people with one child and \$14,120 for those with no children. One in six taxpayers claim the EITC, which unlike most tax breaks, is refundable, meaning that people can get it, even if they owe no tax and even if no tax is taken out of their paychecks.
- The maximum Hope credit rises to \$1,650 (100% of the first \$1,100 of eligible expenses and 50% of the next \$1,100 of expenses). These dollar amounts are doubled for students attending an eligible educational institution in the Gulf Opportunity Zone. The Hope and lifetime learning credits are phased out if a taxpayer's modified adjusted gross income (MAGI) is between \$45,000 and \$55,000 (\$90,000 and \$110,000 if filing a joint return).